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3 June 2016

Submission to the Commonwealth Treasury Discussion Paper on the GST treatment of digital currency

Dear Sir/Madam,

Thank you for the opportunity to comment on the Discussion Paper on the GST treatment of digital currency (the *Discussion Paper*) and the Government's proposed changes to the Goods and Services Tax (GST) regime to address the double taxation of digital currencies.

I attach a Submission to the *Discussion Paper*, prepared by me and Mr Joel Emery.

Please contact Miranda Stewart on +61 2 0125 7713 with any queries or to discuss.

Sincerely

Miranda Stewart

Recommendations

Recommendation 1: The double taxation issue be addressed by treating digital currency as "money" for GST purposes. This could be achieved by amending the definition of "money" in the GST Act to include digital currency, and by inserting a definition of "digital currency".

Recommendation 2: A "combination approach" to defining "digital currency" be adopted, including a statutory definition of "digital currency" combined with a discretionary administrative power to recognise particular digital currencies as falling within or outside the scope of the meaning of digital currency for GST purposes. The definition should focus on the aspects of digital currency relating to its use as money (as this is what gives rise to the double taxation issue) rather than on particular technological features of current digital currencies.

Submission

1. Introduction

Addressing the double taxation of digital currencies is important to ensure neutrality in our GST regime with respect to new technologies. Legislative reform should be done in such a way as to be easily administrable and minimise the risk of unintended consequences. We welcome the opportunity to comment on Exposure Draft legislation in due course.

We note that the Discussion Paper, and this Submission, addresses only the GST treatment of digital currencies. Whilst we argue that it is desirable to treat digital currencies akin to money under the GST regime, this may not be appropriate in other tax and regulatory contexts, so the reform should be specific to the GST law at this stage. However, as digital currencies likely to continue to be subject to rapid development and technological change, it is important to ensure that the law can adapt to changes to digital currency technology.

We recommend that Treasury considers the existence of some form of body to monitor digital currencies, such as the Digital Currency Taskforce proposed by the Senate Committee's Report. This is likely to provide a more holistic and accurate picture of any issues associated with digital currencies in a range of contexts, and better enable regulators to implement any future changes that may be necessary to ensure digital currencies' effective regulation.

As we recommend the treatment of digital currencies as "money" for GST purposes, we have reversed the order in which we address the Discussion Questions. We deal first with the overall GST treatment (Questions 5 to 11) and second with the issue of definition of digital currency (Questions 1 to 4).

2. GST treatment of digital currencies

Discussion Questions

5. Should digital currencies be given input-taxed treatment or be treated equivalently to 'money' for GST purposes, noting the limited differences in outcome and the likely compliance burdens and timeframes for implementation?

6. Are there specific examples of different outcomes between the options that would result in one option being favoured? How frequently would these circumstances arise for relevant businesses? And Further:

7. What effect does each of the options have on the regulatory burdens and compliance costs of different market participants (for example, consumers, merchants and digital currency traders/intermediaries)?

8. Are additional reduced credit acquisitions required to be specified in the GST Regulations to allow access to RITCs for the digital currency industry? If so, what types of acquisitions would they include?

9. Under input taxed treatment or treatment as 'money' for digital currencies, would Australia regain sufficient international competitiveness, compared to other jurisdictions?

10. Does GST-free treatment have any significant advantages that haven't been considered?

11. Are there other options to address the current GST treatment of digital currencies that have not been considered and which would provide significant advantages?

The Discussion Paper considers three approaches to digital currency to address double taxation under the GST regime:

- Treating digital currencies as GST-free
- Treating digital currencies as money (as consideration for a supply); or
- Treating digital currencies as input taxed.

Any of the proposed approaches would remove the requirement for businesses to impose GST on sales of digital currency to Australian consumers, and should regain competitiveness in this respect with other jurisdictions. They would also remove the administrative and double taxation burdens associated with Australian digital currencies businesses (when some jurisdictions have not adopted a favourable approach to digital currency). We expect this to further improve the attractiveness of operating in Australia.

We recommend that digital currency should be treated as "money" for the purpose of the GST law. This would result in digital currencies being exempt as money where used as consideration, and input taxed where they are acquired or supplied in their own right.

The goal of reform is to align the GST treatment of digital currencies with that of their counterpart payment systems as far as possible: that is, to eliminate the double taxation when digital currency is

used like "money". The difficulty with the application of the GST regime arises because the tax treatment of digital currencies differs from with its practical and commercial function and use as money. A minimal approach to address that specific issue should be adopted, involving as little legislative change as possible. This approach would reduce the likelihood of unintended consequences. This approach also more closely follows the principles of technological neutrality and neutrality in the tax system.

This conclusion is based on a desire for legal consistency in the GST regime. This approach should improve Australia's global competitiveness, align its GST treatment of digital currencies with many European jurisdictions, and enhance technological neutrality between digital currencies and comparable modes of payment system or 'money'.

2.1 Digital Currencies as "money"

Our proposed treatment of digital currencies as "money" is intended primarily to achieve consistency between treatment of digital currency and traditional counterpart payment systems.

Under section 9-10(4) of the GST Act, the supply of "money" is excluded from the definition of a "supply" for the purpose of the GST Act. The purpose for this exclusion is pragmatic and intended to prevent double taxation. The Explanatory Memorandum to the GST Bill explained:

"Money that is provided as consideration (payment) for a supply is not in itself a supply … Otherwise money supplied as payment for a supply could be a taxable supply in itself."[1]

"Money" is defined in s 195-1 of the GST Act to "include":

> "(a) currency (whether of Australia or of any other country); and
>
> (b) promissory notes and bills of exchange; and
>
> (c) any negotiable instrument used or circulated, or intended for use or circulation, as currency (whether of Australia or of any other country); and
>
> (d) postal notes and money orders; and
>
> (e) whatever is supplied as payment by way of:
>
> (i) credit card or debit card; or
>
> (ii) crediting or debiting an account; or
>
> (iii) creation or transfer of a debt.
>
> However, it does not include:
>
> (f) a collector's piece; or

[1] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 (Cth) [3.7].

(g) an investment article; or

(h) an item of numismatic interest; or

(i) currency the market value of which exceeds its stated value as legal tender in the country of issue."

The common law meaning of "money"

The definition of "money" in the GST Act is based on the common law or ordinary meaning of the term "money" and includes the common law or ordinary meaning of "currency". The concept of "money" takes a meaning according to its context.[2] Section 195-1 then broadens the definition for GST purposes to include a range of means of payment, but excluding those which have investment value – such as an "investment article" or currency which has a market value exceeding its stated legal tender value.

The terms "money" and "currency" are to some extent used interchangeably in case law and wider discussion, and are subject to different and sometimes interacting statutory regimes. It has been authoritatively stated that "currency" is "the form of money which is authorised to perform the functions of money within a particular community".[3] For example, in *Leask* [1996] 187 CLR 579, the High Court was called upon to interpret a statutory definition of "currency" in the *Financial Transaction Reports Act 1988* (Cth). That statutory definition combined a concept of tangible coinage and paper money with a functional concept of circulation of currency for payment. The concept of "legal tender" refers to "the form of money which is authorised by a particular community for the payment of obligations which are to be satisfied by the payment of money".[4] Moreover, when "money" is a "currency", "it has the quality of negotiability which it shares with bills of exchange, promissory notes, cheques and other negotiable instruments"; when it is not a "currency", it is a chattel (tangible personal property).[5]

In general, the case law reveals two alternative approaches to defining money: (1) a sovereign or fiat definition of legal "currency" and (2) a functional definition in which money operates as as currency or a means of payment and medium of exchange but which does not require money to be recognised by an act of sovereign power.[6] In *Travelex v FCT* [2008] FCA 1961 at first instance, Emmett J adopted the functional "usage" approach to defining "money" or "currency". In that case, he referred to "currency" as being tangible goods, however, as we currently find, technological

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[2] Laws of Australia [18.1.140] GK Burton SC (last updated 1 August 2013); Halsbury's Laws of England (4th ed, Butt (UK), 2005) Vol 32, at [101].

[3] Laws of Australia [18.1.150] GK Burton SC (last updated 1 August 2013), referring to s 8(1) of the Currency Act 1065 (Cth) which establishes that "the monetary unit, or unit of currency, of Australia is the dollar."

[4] Laws of Australia [18.1.160] GK Burton SC (last updated 1 August 2013), referring to s 36(1) of the Reserve Bank Act 1959 (Cth) which provides that Australian notes are legal tender throughout Australia.

[5] Laws of Australia [18.1.280] GK Burton SC (last updated 1 August 2013).

[6] Recently considered in *Travelex v FCT* [2008] FCA 1961; *Messenger Press Proprietary Ltd v FCT* (2012) 90 ATR 69 [196]. See the Appendix for extracts of the relevant discussion. For a detailed discussion, see Joel Emery, "Decoding the Regulatory Enigma: How Australian Regulators Should Response to the Tax Challenges Presented by Bitcoin" (Tax & Transfer Policy Institute Working Paper 1/2016) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2730966>, Part V.

developments indicate that "currency" may be intangible or digital property. In *Messenger Press* [2012] FCA 756, Perram J commented on that approach and observed in *dicta* in a matter concerning income tax treatment of foreign exchange gains and losses, that promissory notes or book debts where the party liable is not a bank or deposit-taking institution are not "money" at common law.

The need for reform of the GST law arises because of the approach taken by the ATO in GST Ruling GSTR 2014/3 which concluded at [66]:

> "Bitcoin is not a legally-recognised universal means of exchange and form of payment by the laws of Australia or the laws of any other country. Therefore, it is not currency."

The ATO concludes in GSTR 2014/3 that sovereign or "fiat" recognition of money or currency is required; so methods of payment must be "denominated in and reducible to fiat currency" (emphasis added):

> "104. The statutory context supports the view of the Commissioner that, although the definition of money is not exhaustive, the fact that the inclusions in paragraphs (b) to (e) are each denominated in and reducible to fiat currency by their nature is a strong indication that 'money' generally for GST purposes cannot and does not extend beyond methods of payment that are denominated in and reducible to fiat currency.[61]
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> 105. Further, the wider context provided by the Currency Act cannot be ignored and is important. Australia has determined that, where transactions are entered into and their performance is measured in money, ***it must be money denominated in the fiat currency of Australia or some other country that is contemplated and required***.
>
> 106. It has been argued that bitcoin satisfies the functional definition of money because it is asserted to serve as a medium of exchange, a unit of account and a store of value. In addition, it is argued that what is asserted as an increasing acceptance within the community as a means of discharging debts and acquiring goods and services has now reached the point that it qualifies as money.
>
> 107. The evidence available to the Commissioner ***informs his view that the current levels of use and acceptance of bitcoin within the community is far short of what may be regarded as sufficient or necessary to satisfy the test in Moss.***[7] In determining whether bitcoin is money for GST purposes, however, it is not necessary to come to any conclusion about whether bitcoin satisfies functional requirements referred to in Moss.
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> 108. Custom alone, whether it be local or international, cannot make something 'money' in the absence of an 'exercise of monetary sovereignty by the State concerned'. Consistent with the statutory context, policy and the wider legislative framework governing Australian

[7] *Moss v. Hancock* [1899] 2 QB 111: ""Money ... (is) that which passes freely from hand to hand throughout the community in final discharge of debts and full payment for commodities, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or apply it to any other use than in turn to tender it to others in discharge of debts or payment of commodities."

> currency established by the Currency Act, this is the sense in which the word 'money' is used in the section 195-1 definition. Bitcoin, therefore, is not 'money' for GST purposes."

There are two features of the common law meaning of money which may not be met by digital currencies such as bitcoin and which therefore may need to be altered for treatment as "money" to be effective:

(1) A lack of sovereign or "fiat" recognition as legal currency in the law of Australia or any other country;
(2) Use or circulation among a community which is "insufficiently" large, not the whole community and not a universal means of exchange and form of payment.

We recommend that the Government amend the GST regime to recognise digital currency as money for purposes of the GST. In our view, this approach best reconciles the GST treatment of digital currencies with that of traditional payment systems.

In effect, and in purpose, digital currencies of the sort that should be subject to any GST amendments are intended to act as a form of electronic money or "currency". We consider that, at least in the context of GST, it is appropriate to treat digital currencies as equivalent to other forms of money and payment system. Characterising digital currency as money is consistent with the purpose behind s 9-10(4), which seeks to avoid treating forms of payment as a "supply". It is also consistent with the general law approach to treating "money" as a means of exchange when operating as "currency" but otherwise as personal property.

Treating digital currencies as money is also not inconsistent with the overall purpose of the GST legislation. Digital currency users should receive similar GST treatment to the users or businesses of fiat currency or comparable payment systems.

The best way to approach these legislative amendments would be to:

1. Include "digital currency" in the definition of "money" under section 195-1 of the GST Act to allow the exclusion in section 9-10(4) of the Act to operate to exclude digital currency provided as payment from constituting a supply subject to GST. This could be dealt with by, for example, adding a phrase such as "whether or not recognised as legal currency" in the definition of money in s. 195-1(a). However, this alone would not address the second point above about "wide" or "accepted" use as a means of exchange and payment in a community or sufficiently wide segment of a community. Alternatively, "digital currency" could be added in a paragraph in s 195-1 and a definition provided for it.

2. Insert a definition of "digital currency" in the Act. We recommend that this definition has regard to our comments and recommendations outlined in Part 3.

Consistency with the approach of other countries

International experience provides some guidance regarding as to how digital currencies may be treated in the Australian GST regime, although the Discussion Paper is correct that there is a diversity of approaches and many countries have not yet actively addressed the issue. The recent approaches in the UK and European Union provide some guidance and their approach tends to

support treating digital currency similar to “money” or other forms of payment recognised as such in the GST law.

In March 2014, guidance released by Her Majesty’s Revenue and Customs (the UK’s ATO counterpart) provided that VAT would not be imposed on transfers of bitcoin and that bitcoin would be treated as “exempt” from VAT. When the UK introduced this approach in 2014, the industry praised it and its potential benefits.

In 2015, the Court of Justice of the European Union decided in *Skatteverket v David Hedqvist*[8] that bitcoin should be treated like traditional currency. The taxpayer, Mr Hedqvist, carried on a business exchanging bitcoins for traditional currency and *vice versa;* much like a traditional currency exchange. This case concerned whether Mr Hedqvist’s business fell within the ambit of the Swedish VAT regime, and if so, whether the exchange of bitcoin for currency was exempt by virtue of Article 135(1)(e) of the EU VAT Directive,[9] which exempts transactions concerning “currency, bank notes and coins used as legal tender”. The CJEU held that Article 135(1)(e) must be interpreted broadly in order to give it its full effect, and that in doing so, bitcoin should be treated as equivalent to “currency”.

This approach is close in effect to treating digital currency as money under the GST regime than to amending the GST Regulations to include digital currency in the definition of financial supply.

Advocate General Kokott commented in relation to the interpretation of Article 135(1)(e) that the purpose of the exemption included avoiding “impeding the convertibility of pure means of payment”, for reason of facilitating cross-border exchange in the common market,[10] and promoting a “smooth flow of payments”[11] recommending that:

> “In so far as means of payment exist which are involved in payment transactions because they fulfil the same payment function in the course of trade as legal tender, the levying of VAT on exchanges of such means of payment would constitute an additional burden on payments.”[12]

The approach in the UK and CJEU also offers support for treating digital currencies as close as possible to their traditional counterpart technologies, to try to apply the law in a way that is technologically neutral.[13]

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[8] Judgement of the Court (Fifth Chamber) 22 October 2015 Case C-264/14. See also Opinion of Advocate General Kokott, *Skatteverket v David Hedqvist* (16 July 2015) Case C-264/14 (“Kokott Opinion”).

[9] This provision seeks to exempt the purchase of money for money (as the CJEU emphasises at paragraphs [26]-[28]), and is more akin to input taxing under the GST Act, rather than providing an exemption from VAT for the provision of money as a mode of payment for goods or services to which VAT is applied, as is the case in section 9-10 of the GST Act.

[10] Kokott Opinion, [38].

[11] Ibid [39].

[12] Ibid [40].

[13] *Skatteverket v David Hedqvist* [45]-[51]; Kokott Opinion, [35]-[39], [41], [45].

2.2 Digital currencies should not be designated as GST-free

An exemption could be provided from GST under section 9-30(2) in conjunction with Division 40 of the GST Act, which excludes them from the definition of a taxable supply, and thus, removes them from the GST tax base.

Broadly, the rationale for this exemption is to avoid levying GST where it might be considered unfair or politically unfavourable to impose a consumption tax – for incidence, on supplies of essential medical care, education, or fresh food. As outlined in Treasury's *Re:Think Tax Discussion Paper*:

"When the GST was introduced, health and education, for example, were made GST-free because of the significant public sector provision of these goods and services and concerns that applying the GST to them would put private providers at a competitive disadvantage. Fresh food was made GST-free as part of negotiations with the Australian Democrats to secure passage of the GST legislation through the Senate. Some stakeholders support the retention of many of these exemptions on the basis that these goods and services are 'basic necessities' and argue that the burden of applying GST to them would fall disproportionally on lower-income households."[14]

Treating digital currencies as GST-free finds little policy support in the rationale behind treating other goods and services as GST-free. Digital currencies are not a "basic necessity" of the sort that created a political imperative to remove other items from the GST base on the introduction of the GST regime.

If digital currencies were to be treated for all purposes as GST-free, they would enjoy a more favourable tax treatment than the traditional counterpart of "money" or other forms of payment.[15]

Making digital currency GST-free would therefore have to be justified by significant improvements in simplicity or reductions in compliance costs. We cannot see any major benefits that would justify the resulting legal inconsistency or policy incoherence associated with this treatment, and recommend that this approach is not adopted.

2.3 Input taxation of Digital Currencies

Financial services are input-taxed in the GST law. As explained in the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* (Cth), the rationale behind input taxing is pragmatic:

> "Most countries that have a GST system exempt financial services as there is no readily agreed identifiable value for supplies consumed by customers of financial services. The approach adopted in the Bill is consistent with the international model."[16]

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[14] Treasury *Re:Think Tax Discussion Paper* (30 March 2015), 133, www.bettertax.gov.au (citations omitted).

[15] The scenario which was considered by the High Court in *Travelex Ltd v FCT* [2010] HCA 33 highlights the significance of this distinction, and the importance of access to input tax credits.

[16] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 (Cth) [5.140].

Input taxed supplies are set out in s 40-5 and in Schedule 7 to the GST Regulations and include “financial supplies” such as interest and credit or debit charges, intra-bank transfers, and mortgages.

The operation of section 9-10(4) is not mutually exclusive to recognition of certain goods or services as input taxed. Where foreign currency is used as payment, because it is a form of money, it is exempt from being a “supply” on the basis of subsection 9-10(4). However, the input tax provisions operate where foreign currency is purchased as the subject of a supply and as thus, s 9-10(4) does not apply (for example, USD was supplied to a consumer, who pays in AUD).

Treating digital currency as input taxed would require the insertion of a “digital currency” item in Schedule 7 to the GST Regulations. This approach does not result in characterising digital currency differently, but rather, represents an expansion of the meaning of financial supply. The Discussion Paper suggests that the “input tax” approach would be “considerably faster”,[17] and that the “money” approach would give rise to “significant technical difficulties and administrative complexities”.[18] It is not clear why the Discussion Paper expresses such concern about this issue. Different common law and legislative definitions of “money” or “currency” apply for a range of different regulatory regimes. We suggest that the issue of different treatment in other Commonwealth legislation or at common law should not prevent treating digital currency as “money” for GST purposes. We observe the many extensions to “money” for GST purposes already in s 195-1. Concern about what will qualify as a “digital currency” is discussed below.

3. Identifying digital currencies

Discussion Questions

1. Should digital currencies be identified for GST purposes by defining them or listing them? If a combination or alternate approach should be used, please describe how it would work.

2. Assuming digital currencies are to be defined for GST purposes, what criteria should be included? Should specific types of other currencies be explicitly excluded in the definition? Would all criteria be given equal weight?

3. Regardless of how digital currencies are identified for GST purposes, should a decision-maker have the capacity to exclude one or more of them under certain circumstances, such as if a currency was being used predominantly for illegal purposes?

4. Regardless of how digital currencies are identified for GST purposes, what can be done to ensure the provisions remain relevant as technology advances?

Discussion Questions 1-4 (*Discussion Paper p. 8)* relate to identifying digital currencies for the purpose of any GST amendments. The Discussion Paper refers to the need to “[identify] precisely

[17] Discussion Paper, [42.1].

[18] Discussion Paper, [48].

what a "digital currency" is, in order to determine what the new treatment applies to".[19] Discussion Paper para 29 explains the pros and cons of a statutory definition.

The Discussion Paper proposes three different approaches to identifying digital currencies for the purpose of the GST regime:

- Statutory definition of digital currency;
- Administrative power of recognition by listing accepted digital currencies; or
- Combination of the above.

We recommend that a legislative definition of digital currency for the purpose of the GST Act should be introduced, combined with a discretionary power allowing the decision-maker to recognise particular digital currencies as falling within or not falling within the definition. This discretionary power should be exercised predominantly to increase certainty where there is a lack of clarity as to whether digital currencies satisfy the statutory definition in order to confine or expand the definition to technological changes not contemplated by the original definition, to maintain the relevance and integrity of the statutory definition.

The essential criteria of the definition should focus on the function of digital currencies as a form of money for real-world transactions. Particular regard should be had to this factor in the case that our recommended treatment of digital currency as "money" under the GST regime was to be adopted.

This approach should provide many of the benefits associated with either a statutory definition (such as adaptability to new technology) or administrative list (such as certainty), whilst minimising the potential difficulties associated with using either approach in isolation (such as unforeseen outcomes or administrative lists becoming out-dated). The essential criteria of the definition should focus on the function of digital currencies as a form of money for real-world transactions.

A statutory definition of digital currency provides a degree of certainty and clarity as to the treatment of digital currencies. It potentially enhances the ability of the GST regime to recognise new, similar digital currencies without the need for administratively-onerous recognition of each individual digital currency. The Discussion Paper recognises that if a definition is too broad in pursuit of this aim, it heightens the risk that it will unintentionally apply to a range of unforeseen forms of property or transaction.

However, legislators should avoid confining the definition by drafting amendments with particular digital currencies or features of digital currencies in mind. There are recognised problems with drafting technology-specific regulations, particularly where technology changes rapidly.[20] It should be remembered that (primarily through bitcoin) digital currencies have only acquired widespread use in the last few years. A definition that relies on features of existing digital currencies may be inadequate to address future technological change that will date the definition.

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[19] Discussion Paper, [28]

[20] See generally, Jonathan Winn, "Clash of the Titans: Regulating the Competition between Established and Emerging Payment Systems" (1999) 14 *Berkley Technology Law Journal* 675, esp. 691.

3.1 Content of a statutory definition

The Discussion Paper identifies the following potential criteria for defining a digital currency, which could form part of their statutory definition:

> "a) A digital or non-tangible unit of account.
>
> b) Not denominated in units of other currencies, making it a unique currency.
>
> c) A commonly used medium of exchange. This could be tested by some objective measure, such as by having a minimum threshold for the total value of the currency in circulation in Australian dollars. However, a test like this may create competitive difficulties for new currencies, as well as uncertainty for currencies near the threshold, where the value in circulation may fluctuate above and below the threshold.
>
> d) Two-way convertibility to real-world goods, services and fiat currency, outside of a centralised exchange. i. This would involve the ability to exchange digital currency for real-world goods, services and fiat currency, as well as change it back again. It could also be contingent on this not having to occur through a centralised entity.
>
> e) Reliance on cryptographic techniques to validate transactions.
>
> f) Lack of centralised control or centralised validation of the currency, such as through the 'distributed ledger'. This could include decentralisation of: the issuance and redeemability of the digital currency; the mechanisms to implement, enforce and validate transactions with the currency; and the payment and settlement process. Hybrid schemes exist, where some functions are performed by a central authority, while others are distributed among market participants."[21]

The factors that relate to the use of digital currencies as money should form the basis of a statutory definition, as it is this aspect of digital currencies that gives rise to the double taxation issue.

Factors a) and b)

We consider that factors a) and b) identified by the Discussion Paper should form part of the definition, as they are central to the function of digital currencies as payment and also are fundamental elements of the common law definition of money.

Factors c) and d)

We agree that it is appropriate to refer to the use of digital currencies as money. Factors c) and d) are another central aspect element of the definition of money. However, satisfying this aspect of the definition of money may prove challenging for many digital currencies. Issues may arise as to what is a "medium of exchange" and about the concept of "commonly used". The ATO reasoning in its

[21] Discussion Paper [33]

determination that digital currency did not constitute money or currency for GST or income tax legislation set a high bar of use.[22]

We agree with the use of factor d) as part of a statutory test, as it is important to distinguish between digital currencies that are used as a form of money for real-world services, and those which are not, or are not intended to have this function. This is a key element in distinguishing between digital currencies such as bitcoin and other forms of virtual property, so it is helpful in limiting the scope of the term 'digital currencies' to those that are intended to be treated like fiat "currency".

One approach could be to require that a digital currency be "reasonably" widely used or accepted a medium of exchange for real-world transactions. Alternatively one could not apply any specific requirements regarding the level of usage but merely that a putative digital currency "serves as a means of payment for real-world transactions".

This could be supplemented by a requirement that a particular digital currency had "frequent" or "significant: use as a means of payment for real-world transactions, to ensure that some use for non-real-world transactions or investment use did not exclude the digital currency from the definition.

It is probably sensible to distinguish between real-world digital currencies and "in-game" currencies, as was proposed by the United States Government Accountability Office (**GAO**).[23] This could become quite complex and any discussion of it may be better suited to guidance materials rather than legislative reform. The GAO draws a distinction between virtual property that is used for real-world services, and virtual property which is not, through a framework which distinguishes between "open-flow", "closed-flow", and "hybrid flow" forms of digital property. Briefly, the GAO outlines that:

- Closed-flow virtual currencies are where the virtual currency is designed to be used purely for purchases of virtual goods or services, and the virtual currency is not designed to interact with, or be exchanged for, real-world goods or services or real-world currency. In other words, the virtual currency exists to be used solely in a virtual sphere, without interaction with the broader world.
- Open-flow virtual currencies are where a virtual currency is designed to be fully interactive with the real-world. Such currencies are designed to be exchanged for real-world money, goods and services, or for virtual goods or services or other virtual money.
- Hybrid virtual currencies are where there is some degree of interaction between the virtual currency and real-world currency or goods. Typically, this is where the virtual currency may be used to purchase both virtual and real-world goods and services, but cannot be redeemed for real-world currency.

The definition could recognise only "open-flow" systems of digital currency as payment for real-world goods and services, or real-world money.

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[22] Above n 14, TD2014/D11 6. This is supported by the Productivity Commission Report's estimate that only approximately 200 Australian businesses use bitcoin. See Productivity Commission Report, above n 18, 241.

[23] United States Government Accountability Office Report to the Committee on Finance, *Virtual Economies and Currencies* (GAO-13-516, May 2013).

Factors e) and f)

These factors focus on the technical features of current major digital currencies. They should not form part of a definition. While they provide some useful context to the sort of digital currencies intended to be covered by the definition, they are indicative only and should not be determinative criteria. For example, these factors could be used in administrative guidance, examples or explanations.

For instance, in relation to factor e), although the use of cryptography is important from a technological perspective and central to most major digital currencies today, it is conceivable that new digital currencies may utilise other forms of validation software or processes in future. The use of cryptography has no impact on the double taxation issue: if new digital currencies were created which were identical to bitcoin except for using a different method of transaction validation, this new digital currency would face the same double taxation issue. There is no obvious justification for this potential distinction in the taxation of cryptography-based and non-cryptography-based digital currencies.

3.2 Administrative power of recognition

The Discussion Paper outlines an alternative approach for digital currencies to be identified through empowering a decision maker (such as the Treasurer or the Commissioner of Taxation) to specify and list the individual currencies that would be digital currency for the purposes of the GST law.

We do not recommend the adoption of a list of recognised digital currencies in the GST law or regulations, whether by legislation or administrative process. Such a list is likely to be onerous to create and maintain, given the number of digital currencies in existence, and the rate at which new digital currencies appear and adapt (each of which would require examination). Although a list would increase certainty surrounding the treatment of existing digital currencies and limit unintended consequences, it would likely become quickly outdated. We agree with the Discussion Paper's concern about a potential time lag and administrative costs, and a competitive advantage for existing currencies, or lag in removing unsuitable older currencies.[24]

The exercise of this power should be focused on preventing unforeseen, unintended forms of virtual or digital property falling within the definition, or maintaining the integrity of the definition by expressly rejected forms of digital currency that are used primarily for virtual-world transactions (like in-game money).

If a discretionary administrative power is to be adopted, we recommend that this should be done in conjunction with a statutory definition – the "combination approach".

3.3 Combination approach

The third option is for the above approaches to be combined: "A combination approach could take one of a number of forms. For example, it could involve giving more limited power to a decision

[24] Discussion Paper, [30].

maker to list a digital currency but only if it first satisfies an established definition. Alternatively, it could involve adopting a principled definition, but also allowing a decision-maker to include or exclude specific currencies."[25]

Adopting a combination approach to identifying digital currencies has attractions. It would include a statutory definition focused principally on the functional use of digital currency as money, rather than on their technological attributes. This definition could operate in conjunction with administrative guidance listing recognised digital currencies that satisfy this functional test, and potentially a discretionary administrative power to recognise a digital currency that also satisfies the test.

The use of a statutory definition with administrative guidance should provide clarity for users of the most widely distributed digital currencies, such as bitcoin. A statutory definition could enhance users' ability to ascertain whether new digital currencies fall within the meaning as prescribed by the Act, minimising the 'lag time' associated with new digital currencies obtaining recognition from a decision-maker.

A discretionary power would be supplementary; to be applied where there is uncertainty, or the application of the statutory definition is considered to be too broad or too narrow. This would empower the decision-maker to include or exclude forms of digital property that it reasonably considers are not performing the function of a currency or payment system.

We recommend that a better approach is to implement a 'combination approach', which involves a statutory definition, combined with a discretionary administrative power to recognise digital currencies as being within or not within the definition. This approach would seek to maintain integrity by allowing the decision-maker to include or exclude certain technologies if necessary, and to maintain the relevance of definition in the event of technological change potentially outdating a statutory definition.

A discretionary power could empower the decision-maker to:

- Prescribe a digital currency, currencies, or a broad class or type of digital currencies that will be treated as digital currencies, as long as they satisfy the features of the core statutory definition, for certainty; and
- Withdraw or exclude particular digital currencies from recognition (e.g. in the event that the digital currency was primarily being used as payment for in-game, virtual-world assets).

It is appropriate that the exercise of discretionary power should have regard to the underlying policy behind the treatment of digital currencies including neutrality with other forms of "money". This is particularly important if our recommended approach of treating digital currencies as 'money' under the GST regime was to be adopted. Other criteria could also be considered, such as a requirement to have regard to establishing technological neutrality.

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[25] Discussion Paper [31].

3.4 Use of Administrative Guidance

Administrative guidance should be provided to assist stakeholders and administrators in distinguishing between digital currencies and other technologies which are within and outside the scope of the definition and recognition as digital currencies for GST purposes.

This could include guidance in explanatory materials to the Bill(s) through which changes to the GST regime are introduced and in administrative rulings.

If a Digital Currency Taskforce were created, collaboration with this body, the decision-maker and the ATO for this purpose is likely to be beneficial.

Appendix

Definition of "money" in recent Australian cases (Extracts)

Travelex v FCT [2008] FCA 1961 (per Emmett J at first instance)

23. Currency, consisting of coins and bank notes, is tangible property, in the sense that they can be transferred by delivery and can be the subject of possession. However, because of the particular significance that is attached to currency as being money, currency that consists of coins or bank notes will, for many purposes, not be regarded as goods.

24. In that regard, the term "currency" may have different usages in relation to money. In the sense in which I have just used it, the term is a synonym for the medium of exchange itself, namely, coins and bank notes circulating in a particular polity. In another possible usage, the term refers to a characteristic feature of the proprietary regime that applies to money. That is to say, the full force of the general rule on derivate transfers of title does not apply to title to money, in that title to money is exempt from the maxim *nemo dat quod non habet*. In that regard, currency refers to the negotiability of money, such that, as a general rule, the right to money is inseparable from the possession of it. Where coins or bank notes are delivered in payment of a debt or for the provision of goods or services, it is not incumbent upon the recipient of the coins or bank notes to enquire into the title of the payer. Not only possession of, but also property in, coins and bank notes passes by mere delivery, irrespective of the title of the payer (see *Miller v Race* (1758) 1 Burrow 452 and David Fox, *Property Rights in Money* (Oxford University Press: Oxford, 2008) at 265-6 and the authorities there cited).

25. Money is any generally accepted medium of exchange for goods and services and for the payment of debts (see *Butterworth's Australian Legal Dictionary* at 759). Currency and legal tender are examples of money. However, a thing can be money and can operate as a generally accepted medium and means of exchange, without being legal tender. Thus, bank notes have historically been treated as money, notwithstanding that they were not legal tender. It is common consent and conduct that gives a thing the character of money (see *Miller v Race* (1758) 1 Burrow 452 at 457). Money is that which passes freely from hand to hand throughout the community in final discharge of debts and full payment for commodities, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or apply it to any other use than in turn to tender it to others in discharge of debts or payment for commodities (see *Moss v Hancock* [1899] 2 QB 111 at 116).

Messenger Press Proprietary Limited v Commissioner of Taxation [2012] FCA 756 (per Perram J)

> 194 That makes it unnecessary to determine whether, as here, the delivery of a promissory note denominated in foreign currency in exchange for a release of a book debt denominated in Australian dollars is an exchange of foreign 'currency', for it is certainly an exchange of liabilities.
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> 195 Lest I be wrong about that I should record my view that these concepts, at least for legal purposes, are not money. In this area difficult issues about the nature of Australian money and foreign money may arise. In *Moss v Hancock* [1899] 2 QB 111, Darling J approved at 116 the definition of FA Walker in *Money, Trade and Industry* (London, 1882) that money is
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>> that which passes freely from hand to hand throughout the community in final discharge of debts and full payment for commodities, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or apply it to any other use than in turn to tender it to others in discharge of debts or payment for commodities.
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> 196 No doubt, this definition has its limitations: C. Proctor, *Mann on the Legal Aspects of Money* (Oxford University Press, 6th Ed, 2005) at [1.07]-[1.14]. It was adopted by Emmett J of this Court in *Travelex Ltd v Federal Commissioner of Taxation* (2008) 71 ATR 216; [2008] FCA 1961 at [25]. The definition suffers from the obvious defect that it does not include the exchange settlement funds held by banks with a central bank. Such funds are not available to the community at all, passing only between banks. They nevertheless constitute the monetary base of the payments system. Regardless of where the lines might be drawn I do not think, however, that promissory notes or book debts where the party liable is not a bank or deposit-taking institution can constitute 'money'. There was no evidence that the promissory notes had taken on the quality of being able to be used throughout the community for the discharge of debts and, if they did have that quality, any reasonable person would certainly make inquiries as to the 'character or credit' of the issuer before accepting such a note. There was no evidence that the promissory notes were an integer in some payment system. Nor, where the promissory notes were not presented for payment, is it possible to identify another flow of funds which might usefully be seen as 'money' (i.e. that which might have occurred if a bank account had been credited on presentation of each note). In any event, it is not necessary to pursue these matters further.